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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 000944

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - ASHAB AND CPLANTIER
NSC FOR BRYZA AND MCKIBBEN

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TAGS: [EFIN](#) [TU](#)

SUBJECT: TURKISH CENTRAL BANK GOVERNOR ON IMF DISPUTE

REF: A. ANKARA 812

[TB](#). ANKARA 686

[TC](#). ANKARA 606

Classified By: Deputy Chief of Mission Robert Deutsch for reasons 1.4 (b) and (d).

[¶11.](#) (C) Summary: Central Bank Governor Serdengecti described how the government's effort to extend regional investment incentives over the objection of the IMF opened the door to a resurgence of the dangerous political notion that Turkey could go it alone without the support of the IMF in particular or the outside world in general. The current economic cost of not moving ahead with the IMF was that interest rates will remain higher than they would otherwise need to be. When markets wake up to the seriousness of the impasse, he expects turbulence, but not a crisis. End Summary.

The Return of Populism

[¶12.](#) (C) In a February 17 meeting, Central Bank Governor Serdengecti told Econcouns how he had hoped that by February his life would have settled down following the setting of a date to start EU negotiations, introduction of the new Turkish lira, and agreement on a new IMF program. Instead, he has as much to worry about as ever. Saying "nothing has been done since December 17," he is worried not only about the fate of the IMF program, but about the lack of action to influence EU public opinion about Turkey, on Cyprus, and a number of other issues.

[¶13.](#) (C) Serdengecti said the government could not afford to relax or lose time. It needed to move ahead proactively to shore up Turkey's economy and reduce its vulnerability to exogenous shocks. To the contrary, however, there seems to be a resurgence of "an old nationalist/populist view" that Turkey could go it alone and did not have to worry about the outside world. He saw a political connection between recent anti-American statements and opposition to economic reforms. The same parliamentarians who voted against the March 1, 2003 motion that would have allowed U.S. forces to transit Turkey into northern Iraq were, he said, the ones who oppose economic reform.

[¶14.](#) (C) On the proposed expansion of investment incentives, Serdengecti said he could not understand how the government could make the same mistake it made last year, when it raised the minimum wage just after having agreed on a program with the IMF. Exasperated, Serdengecti said, "These people will never learn." Despite all his efforts, the political leadership obstinately refuses to recognize that the success of the fight against inflation is their biggest popular asset. "They" persisted in searching for subsidies and handouts that undermined the very policies that made them popular. He called recent public statements by ministers (he singled out Finance Minister Unakitan) that seem to defy the IMF and the outside world in general especially harmful.

When Markets Do React, Watch Out

[¶15.](#) (SBU) According to Serdengecti, the lack of an IMF program means that the Bank cannot cut interest rates as quickly as positive economic fundamentals would otherwise allow. He was not surprised by the slowness of a market reaction to the problem with the IMF, saying he has seen the market phenomenon before. Blinded by high yields, markets at first try to ignore brewing problems, but at some point they wake up. Then the lira falls and interest rates go up. Then the government acts. Although there would not be a "crisis" as in the old days, the Governor said he expected "turbulence" when markets acknowledge the seriousness of the differences with the IMF and the government's intransigence.

[¶16.](#) (SBU) The Governor noted that large amounts of foreign currency continue to flow into the market, particularly "from

London, where they have good ties with the IMF." When these investors "bail," they will have been warned that the Central Bank will not facilitate their exit by buying up lira. He said he tells foreign investors "we will buy foreign exchange, but we won't sell." Note: In the 38 auctions held since the central bank resumed its foreign exchange purchase auctions December 22, the Central Bank has purchased \$1.178 billion of foreign exchange. It also purchased \$1.35 billion when it intervened on January 27. End Note.

Comment

17. (C) Serdengecti said he will continue to be fierce in his independence and speak out when government policy heads the wrong way. He expected the Monetary Policy Council to issue a strong statement after its March meeting. As a lonely voice, he expects more personal attacks from politicians who have not accepted the principle of central bank independence. He noted as an example how when The Banker magazine named him "Central Banker of the Year" only one minister (Energy Minister Guler, a critic of Bank policies) called to congratulate him. He told other stories of harassing, petty assaults on the Bank by the "deep state."

18. (C) Like the strong language used by IMF Resrep Bredenkamp, the sharpness of Serdengecti's tone shows the difficulty in communicating an unwelcome message to the political leadership. Serdengecti said the business community, mainly as represented by TUSIAD, was similarly vocal, and similarly frustrated. There are, however, in very recent days some signs that the government may be getting the message and may be ready to compromise on the regional incentives package. It may still, however, require more shrill language and damaging market "turbulence" before the current impasse is resolved.

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